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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and
COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE APPELLEE, GETTY OIL COMPANY

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BRIEF FOR THE APPELLEE, GETTY OIL COMPANY

STATEMENT OF THE CASE

A. Jurisdiction Over Ratable Taking.

The physical properties of gas make it necessary to regulate the taking of gas from reservoirs so that each party owning an interest in a gas reservoir will obtain his fair share of production. The problem presented in this case is described in a similar ratable take case, *Northern Natural*

Gas Corp. v. State Corporation Commission, 362 P.2d 599 (Kan. 1961):

> We do not read the record to show that there is any contention but that drainage was occurring, and that the underproduced wells were losing the right to produce gas from the common source of supply to the great damage of the owners of the wells and the loss of the correlative rights.
>
> While members of this Court make no claim to be experts in the science of the production of natural gas, we believe that the Court may take judicial notice of the fact that where natural gas is in the earth in one common source and is under pressure, if one gas well is allowed to take gas, this will result in the pressure being lowered around the vicinity of this gas well so that the gas in the common source will tend to drain or rush to the vicinity of the well taking gas. The result will be that the other wells in the common field of source will be able to produce much less gas and the owners of such wells will have suffered a definite loss.

Under the "Rule of Capture", which applies in Mississippi and the United States, the owner of a tract of land acquires title to the oil and gas which he produces from the wells drilled thereon, though it may be proved that part of such oil or gas migrated from adjoining lands. Hardwick, "The Rule of Capture And Its Simplications As Applied To Oil And Gas," 13 Texas Law Review 391 at 393 (1935). Under this rule, a landowner with a producing well on his tract is not liable to adjacent landowners whose lands are drained as a result of such operations. The remedy of the injured landowner under such circumstances has generally been said to be that of self-help—"go and do likewise". The rule of capture made it economically imperative that each mineral

owner drill his land and produce at as rapid a pace as possible, for otherwise his land would be drained of oil and gas by wells under adjacent tracts. However, where gas production is involved, the problem is even more complicated. Gas can only be produced by a well when there is a pipe line willing to transport the gas to a market. To protect all of the owners in a pool in situations where an owner of a well did not have a market for his gas, the producing states enacted legislation commonly called "common purchaser statutes" or "ratable take rules" which guaranteed a market for all owners of interest in producing wells. Under the statutes and rules if a purchaser purchases production from one owner in a gas pool or oil pool, then he must make a market available for all owners in the pool who do not otherwise have a market. e.g. § 53-3-1, *et. seq.*, Mississippi Code of 1972 and Rule 48 of the Mississippi State Oil and Gas Board promulgated thereunder. Constitutionality of these statutes has long been recognized. *Champlin Refining Co. v. Corporate Commission of Oklahoma*, 286 U.S. 210 (1932); *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179, (1950).

B. Natural Gas Act, Phillips Case and Northern Natural Gas Company Case

In 1938, Congress determined that there should be federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate commerce and passed the Natural Gas Act. 15 U.S.C.A. §§ 717-717(z). Section 1(b) of the Act (§ 717(b)) provides that the Act shall apply "to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for alternate public consumption for domestic, commercial, industrial or any other use, and to natural gas companies engaged in such transportation or sale. . . ." In *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954),

this Court applied the Natural Gas Act to sales of gas from independent producers to interstate pipe lines. As a result of the *Phillips* decision, no interstate pipeline company could purchase gas without the approval of the Federal Power Commission ("FPC"). The FPC controlled the price paid for gas in acquisitions by pipe line companies. Under the regulatory scheme created by the Natural Gas Act, no room was left either for direct state regulation of the prices of interstate wholesales of natural gas, or for state regulations which would directly achieve the same result. *Northern Natural Gas Corp. v. State Corporation Commission*, 372 U.S. 84 (1963) (holding that a ratable take statute indirectly affected the price of gas and therefore was preempted by the Natural Gas Act). Furthermore, gas, once transported and sold in interstate commerce could not be removed from the interstate market without the consent of the FPC through abandonment proceedings.

The result of this federal regulation was the establishment of an artificially low price for gas sold in interstate commerce. The FPC would only allow gas to be sold into the interstate market at a price which it approved. The price which the FPC approved was an artificially low price. Once a producer sold gas in the interstate market, he could not subsequently remove it from the interstate market for a higher intrastate sales price without the approval of the FPC. The result was two-fold. Initially, oil and gas operators simply did not drill gas prospects since the only substantial market was the interstate market and the price which the FPC would allow for gas sold in the intrastate market did not justify the drilling of exploratory wells to discover new gas reserves. Later, when the intrastate market developed, producers sold any newly discovered gas which was not previously committed to the interstate market to intrastate customers because the price which intra-

state customers were willing to pay was the market price of the gas and was considerably higher than the artificially lower interstate price allowed by the FPC.

C. Gas Shortage and the Natural Gas Policy Act of 1978

The result of the federal regulation by the FPC under the Natural Gas Act of 1938 was a gas shortage by the 1970's. The artificially low price established by the FPC resulted in an increased demand for natural gas as users of other fuels switched to natural gas which was cheaper. Exploration for development of new gas supplies decreased since the FPC imposed ceiling prices did not reflect inherently increasing costs incurred in the producing industry. Gas reserves were depleted and were not replaced by new supplies. Beginning about 1971, interstate pipelines began to "curtail" customers below their contract demands for lack of gas supply. From 1969 to 1977, reserves of new natural gas averaged about half the gas consumed each year. Johnston, Natural Gas Sales Contracts, 34th Institute on Oil and Gas Law, page 83.

On April 20, 1977, President Carter announced his "Moral Equivalent War" energy plan which was an attempt to resolve the energy crisis. Various bills were introduced into Congress seeking different approaches to resolve the problem. Some parties advocated continuing regulation of a different type while others advocated total deregulation. The result was a compromise called the Natural Gas Policy Act of 1978 ("NGPA"). Senator Ribicoff in one of the floor debates made the following statement:

> Certainly this conference report is not a perfect piece of legislation. It is not the program the President originally envisioned. It is not what those opposed to any deregulation or those supporting the industry desire. It is a compromise and is an important start.

124 Cong. Rec. 29101 (1978).

Under the compromise, for those who wanted continued regulation it imposed federal price controls on intrastate market for the first time. For those who proposed deregulation, it removed, in § 601(a)(1) high cost gas from the provisions of the Natural Gas Act and the jurisdiction of the Commission.

D. Transco's Refusal to Take Ratably and Rule 48 Proceedings

The following situation led to this litigation. These facts are not in dispute.

The Harper Sand Gas Pool is productive in both the Greens Creek Field and the East Morgantown Field. These two fields are contiguous. If only one well were completed in this pool and produced from this pool, it would drain the entire pool. J.A.-87; J.A.-91

The Getty-Rogers 28-11 Well, the Getty-Sipp 20-9 Well, the Tomlinson-Willoughby 3-5 Well, the Getty-Buckley 33-6 Well, the Florida Exploration-Carlisle 4-2 Well and the Florida Exploration 29-1 Well produce from the Harper Sand Gas Pool. The Harper Sand Gas Pool lies below 15,000 feet and all of the wells producing from this pool have been classified as deep, high-cost wells under Section 107(c) of the Natural Gas Policy Act of 1978, 15 U.S.C.A. § 3317(c) (NGPA). J.A. 88.

Transco has bought gas from Getty-operated wells in the Greens Creek and East Morgantown Fields since April, 1981. Although Transco has a gas contract with Getty to purchase Getty's gas, it did not negotiate gas purchase contracts with all of the working interest owners (persons owning leases or unleased mineral interests) in the Getty-operated units. Transco took the full production from each

Getty-operated well. J.A. 105. Pursuant to the operating agreements covering the Getty-operated units, Getty delivered to Transco the gas attributable to the working interest of those persons who had not contracted with Transco (nonsignatory parties). Transco paid to the nonsignatory parties the same price that it paid Getty under the terms and conditions of Getty's gas purchase contract with Transco. (JA-113) This practice was consistent with Rule 48, which forbids purchasers from discriminating in favor of one owner, operator or producer against another in the same common source of supply.

Shortly before June 1, 1982, Transco advised Getty Oil Company, operator of the Getty-Sipp 20-9 Well, the Getty-Rogers 28-11 Well, and the Getty-Buckley 33-6 Well, that effective July 1, 1982, it would take only that production attributable to the pro rata working interest of the owners who had executed gas sales contracts with Transco, and until further notice, would no longer take any gas delivered by the operator under the operating agreement. The same notice was sent to Tomlinson Interests, Inc., operator of the Tomlinson-Willoughby 35 Well and other wells in said fields. J.A. 41; J.A. 61.

Upon receipt of this notice, Getty notified the nonoperators (parties owning leases and unleased mineral interests) in the units which it operated who did not have gas sales agreements with Transco (nonsignatory parties) about Transco's decision not to purchase gas from nonsignatory parties under the operating agreement. Tomlinson also notified the nonoperators in the units it operated of this decision. J.A. 39; J.A. 48.

In July, 1982, Transco wrote the nonsignatory working interest owners in the Getty operated units that it would

buy their gas on terms less favorable than those contained in the Getty contract with Transco. J.A. 66.

In response to Transco's notice that it would purchase only that gas attributable to the pro rata working interest of the signatory parties, Getty reduced its July, 1982 deliveries from each of its wells producing from the Harper Sand Gas Pool. Transco was obligated to take all of the production from Florida Exploration-Carlisle 4-2 Well and the Florida Exploration-Barnes 29-1 Wells (located on adjoining units) and continued to take one hundred percent of production from said wells. J.A. 136.

Coastal Exploration, Inc. ("Coastal") owns a small undivided working interest in the Getty-Rogers 28-11 Well, the Getty-Sipp 20-9 Well, the Tomlinson-Willoughby 3-5 Well and the Florida Exploration-Barnes 29-1 Well. (JA-29) Coastal has not signed a gas sales contract with Transco, and accordingly, was a nonsignatory nonoperator who received the above notices and letters. J.A. 66; J.A. 71.

On July 29, 1982, in Docket Nos. 287-82-418 and 287-82-467, Coastal filed a petition with the State Oil and Gas Board of Mississippi to require Transco to comply with Statewide Rule 48 by ratably taking and purchasing gas from wells producing from a common pool in the Greens Creek and East Morgantown Fields without discrimination in favor of the operators of the wells as against Coastal. J.A. 1-2.

The matter was heard by the Board at its September, 1982 meeting. The evidence showed that Transco refused to take from the Getty operated wells any amounts in excess of the pro rata share of interests that Transco was contractually obligated to take and consequently were not taking ratably from the field. J.A. 137. The Board ordered Transco to take ratably and purchase without discrimina-

tion. J.S.App. C at 112(a). On appeal the Mississippi Supreme Court affirmed the Board's Order to the extent it requested Transco to take and purchase gas ratably from all owners in a common pool. It reversed any part of the Order that required Transco to pay at the Getty-Transco contract price stating that Rule 48 just applied to quantity and not to price. J. S. App. A at 48a-44a. The Court overruled Transco's claims that the Board's Order violate Transco's preemption and commerce clause defense.

SUMMARY OF ARGUMENT

I. Rule 48 Is Not Preempted By The NGA Or The NGPA

The Natural Gas Policy Act of 1978 (NGPA) was a result of the gas shortage in the 1970's. The floor debates and the committee reports indicate a recognition by Congress that past regulation of interstate gas had caused the shortage and an intention by Congress to provide some deregulation to stimulate development of new gas reserves.

Members of Congress were divided on how much regulation should continue and how much should be removed. The final act which was passed by Congress was a compromise. Overall the act moved in the direction of deregulation. To appease those seeking continued regulation, FERC acquired jurisdiction over intrastate sales. To appease those seeking deregulation, first sales of Section 107 High Cost Gas were completely deregulated.

In clear terms in Section 601 of the act first sales of High Cost Gas was removed from regulation under the Natural Gas Act (NGA). The result was that the impact of *Northern Natural* on ratable take rules was removed since it was based upon NGA jurisdiction over first sales of natural gas. Now that these sales of High Cost Gas are no longer subject to federal jurisdiction under the Natural Gas Act and

Northern Natural is no longer applicable, ratable take rules such as Rule 48 of the Mississippi Oil and Gas Board are no longer preempted.

II. Rule 48 Does Not Violate The Commerce Clause

Rule 48 produces two primary results. First, it protects the rights of all parties in an oil or gas reservoir so that each owner can obtain his fair share of production. Secondly, it promotes development of oil and gas since parties risking exploration dollars will be assured that they will be able to market any oil or gas they encounter; this same reason makes it easier for them to obtain the financing necessary for drilling.

The test to determine whether a state action violates the Commerce Clause of the Constitution is best set forth in *Pike v. Bruce Church*, 397 U.S. 137 (1970). Rule 48 and Order No. 409-82 promulgated thereunder comply with this test.

First, Rule 48 regulates evenhandedly. It treats Mississippi citizens and non-residents in a non-discriminating manner.

Secondly, it effectuates a legitimate local public interest. The protection of the rights of all owners in an oil or gas pool and the promotion of development of natural resources has long been recognized as a legitimate local interest.

Thirdly, the burden imposed on interstate commerce is not clearly excessive in relation to the putative local benefits. In fact it is Getty's position that Rule 48 is a benefit, not a burden to interstate commerce, since it encourages production of gas for the interstate market. Even if the take or pay costs referred to by Transco are a burden, they are a burden caused by Transco through its gas contract and cannot be laid upon Rule 48.

Finally, there are no alternative means of accomplishing the same result with lesser impact on interstate activities. If the sole regulation is on producers and not on purchasers, then purchasers will control production in all states. If a pipeline purchaser refuses to take ratably, then ratable production is impossible because an operator can only produce that which a pipeline purchaser will take. This will have the effect of passing production controls to interstate pipelines. This is contrary to the long recognized regulatory scheme wherein states have jurisdiction over production. Finally this standard is not even reached since there is no undue burden on interstate commerce imposed by Rule 48.

Therefore, Rule 48 meets all of the above tests and does not violate the commerce clause.

ARGUMENT

I. Rule 48 is Not Preempted Because the Natural Gas Policy Act of 1978 Removed First Sales of Section 107 Gas From Federal Jurisdiction Under the Natural Gas Act.

A. Background of Act and Scope of Section 601.

As mentioned previously, federal regulation of first sales of gas into the interstate market met with disastrous results. Few producers were willing to explore for gas and sell it in the interstate market due to the regulatory burdens. This is described in Rush Moody's Article: The Natural Gas Policy Act of 1978: Analysis and Overview, Twenty-Fifth Annual Rocky Mountain Law Institute 21 (1979) wherein he analyzes Section 601 of the NGPA.

> Under the Natural Gas Act, FERC is authorized, and indeed required, to regulate interstate transportation of natural gas and sales for resale in interstate commerce. This regulation extends not only to wellhead pricing but also to the entry into and abandonment

> from the interstate market. By way of marked contrast, gas not committed or dedicated to the interstate market is not so regulated, absent a comparable state regulatory scheme. *Given this dichotomy of regulation, many producers have been reluctant to sell their production in the interstate market for fear of being subject to this federal regulatory structure. Section 601 of the NGPA was enacted in order to remove certain sales and transportation arrangements from FERC jurisdiction under the NGA, and to thereby eliminate many of the actual and psychological impediments to the introduction of more natural gas to the interstate market.* (Emphasis added)

During the legislative hearings which preceded the enactment of the NGPA, it was apparent to all parties that some deregulation was necessary to counteract the diminishing flow of gas into the interstate market. The floor debates are replete with speeches urging the necessity for deregulation. For example, Senator Bellmon stated:

> There can be no doubt as to why there is plenty of gas in the unregulated market and shortages in the regulated market. There is plenty of gas in the unregulated market because that market is unregulated. It is that simple. There is a shortage of gas in the regulated market because that market is regulated. Seldom is any affliction so easily diagnosed. Seldom is any remedy so easily prescribed. *The affliction is federal regulation. The remedy is to end federal regulation.*

124 Cong. Rec. 29103 (1978). *See also*, 124 Cong. Rec. 29101 (1978) (Statement by Senator Ribicoff concerning burdensome FERC regulations).

The legislative history of the NGPA makes it abundantly clear that the NGPA was a *compromise* between those

groups who favored deregulation and those who were opposed to deregulation. For example, Senator Ribicoff in one of the many floor debates stated as follows:

> Certainly this conference report is not a perfect piece of legislation. It is not the program the President originally envisioned. It is not what those opposed to any deregulation or those supporting the industry desire. It is a *compromise* and is an important start.

124 Cong. Rec. 29101 (1978). *See also*, 124 Cong. Rec. 29100-29103 (1978); 124 Cong. Rec. 30012-30014 (1978); 124 Cong. Rec. 30025-30026 (1978).

Under the compromise, those favoring continued regulation obtained provisions subjecting intrastate gas sales to FERC jurisdiction. For those favoring deregulation there was a total deregulation of sales of Section 107 High Cost Gas. The Joint Explanatory Statement of the Committee on Conference, which accompanied the NGPA, shows that Congress *intended* to remove high cost natural gas from FERC's dominion and control by enacting Section 601 of the NGPA. The Joint Explanatory Statement explains as follows:

> The conference agreement limits the jurisdiction of the commission under the Natural Gas Act in a manner similar to the House-passed bill.
>
> Natural gas not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act is never made subject to the commission's jurisdiction under Section 1(b) of the Natural Gas Act. The commission's jurisdiction under Section 1(b) of the Natural Gas Act ceases after the date of enactment of this Act for the following categories of natural gas:

> High-cost natural gas which qualifies for deregulated price treatment under Section 107(c)(1), (2), (3) or (4).

H. R. Rep. 1752, 95th Cong., 2nd Sess. 123 (1978); S. Conf. Rep. 1126, 95th Cong., 2nd Sess. 123 (1978); *reprinted in* 7 U.S. Code Cong. and Adm. News, 1978 at 9040.

The Joint Explanatory Statement makes it abundantly clear that the deregulation of Section 107 High Cost Gas was not mere price deregulation, but was *total* deregulation.

> Committed or dedicated to interstate commerce
>
> The term committed or dedicated to interstate commerce, for purposes of this Act, means natural gas from the outer continental shelf and most natural gas which if sold, would be required to be sold in interstate commerce within the meaning of the Natural Gas Act. The definition is intended by the conferees to clarify any uncertainty resulting from recent court decisions as to what natural gas may qualify under what price categories in Title 1 of this Act, and what natural gas may qualify for non-price deregulation in Title 6 of this Act.

H. R. Rep. 1752, 95th Cong. 2nd Sess. 71 (1978); S. Conf. Rep. 1126, 95th Cong. 2nd Sess. 71 (1978); *reprinted in* 7 U.S. Code Cong. and Adm. News, 1978 at 8987. Not only does the legislative history show that Congress intended to remove Section 107 High Cost Gas from federal jurisdiction, the wording of Section 601 of the NGPA is explicit in this removal:

> Section 601 Coordination with the Natural Gas Act.
>
> (a) Jurisdiction of the Commission under the Natural Gas Act.
>
> (1) Sales—

> (A) Natural Gas Not Committed or Dedicated.—For purposes of Section 1(b) of the Natural Gas Act, effective on the first day of the first month beginning after the date of the enactment of this Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act solely by reason of any first sale of such natural gas.
>
> (B) Committed or Dedicated Natural Gas.—Effective beginning on the first day of the first month beginning after the date of the enactment of this Act, for purposes of Section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is—
>
> (i) high-cost natural gas (as defined in Section 107(c)(1), (2), (3), or (4) of this Act). . . .

Moreover, with respect to the status of pipeline purchasers of deregulated gas, Section 601(a)(1)(D)[1] of the Natural Gas Policy Act provides as follows:

> D. Natural Gas Company—For purposes of the Natural Gas Act, the term 'natural gas company' (as defined in Section 2(6)[2] of such Act) shall not include any person

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[1]15 U.S.C.A. § 3431(a)(1)(D).

[2]15 U.S.C.A. § 717a(6).

> by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

Section 2(6) of the Natural Gas Act defines a "natural gas company" as "a person engaged in the transportation of natural gas in interstate commerce, for the sale in interstate commerce of such gas for resale."

Read together, these statutory passages directly affect Transco's status as a purchaser of natural gas. When Transco purchases gas which is removed from FERC's jurisdiction by Section 601(a) (1)(A), (B), or (C), as to those purchases, Transco, too, is removed from the FERC's NGA jurisdiction, for it is no longer a "natural gas company" subject to FERC's jurisdiction under the NGA. Although FERC's NGA jurisdiction over Transco remains as to the *transportation* of gas in interstate commerce, the NGPA expressly provides that Transco, as a *purchaser* of this deregulated gas, is not regulated by FERC.

Thus, the *Northern Natural* decision is clearly inapplicable as to Transco's purchases of deregulated gas such as the Harper Sand Gas Pool. Both the gas in question and the pipe line which purchases it are, by the operation of the Natural Gas Policy Act, removed from the ambit of the Natural Gas Act. With respect to deregulated gas, FERC's jurisdiction over Transco's activities begins in the transportation link of the interstate pipe line system. Transco's field purchases of deregulated gas are not regulated by the Commission. FERC's authority, which is defined by Section 1(b) of the Natural Gas Act, and which is circumscribed by the operation of the Natural Gas Policy Act, does not, in the case of deregulated gas, back up to the wellhead. Such an assertion

is, when read in light of the applicable statutes, impossible. Such an interpretation of the NGPA would make Section 601 and the intent of Congress in enacting the NGPA meaningless.

Finally, it is worth noting FERC's recognition of deregulation of High Cost Gas under the NGPA. In the preamble to its interim rules implementing the Natural Gas Policy Act, FERC explained the effect of the NGPA upon continued NGA regulation:

> If gas is not committed or dedicated to interstate commerce as defined in Section 2(18) or is exempted from the jurisdiction of the NGA under Section 601(a)(1)(B) as high cost natural gas, new natural gas, or natural gas produced from any new onshore production well, the prior framework of utility type regulation under the NGA no longer applies.
>
> If natural gas sales are freed from the requirements of the NGA, several adjuncts to NGA regulation are obviated. First, there is no longer any necessity for a producer to seek certification of the sale as serving the public convenience and necessity. The replacement for this requirement under the NGPA is limited to the prior determination mechanism, where applicable, and the pricing limits established in the NGPA. New sales of such gas in interstate commerce no longer require certification as a prerequisite to commencement of deliveries. Nor does the requirement for abandonment authorization before termination of deliveries of natural gas exist with respect to natural gas no longer subject to NGA regulation. In the case of first sales of natural gas not previously committed or dedicated to interstate commerce or exempted from NGA regulation, tariff

> filings and rate increase applications are dispensed with.

43 Fed. Reg. 56455-58 (1978).

B. Decisions Construing Section 601

Cases construing Section 601 of the NGPA recognize that the first sales of Section 107 High Cost Natural Gas have been removed from federal jurisdiction.

In *Conoco, Inc. v. Federal Energy Regulatory Commission*, 622 F.2d 796, (5th Cir. 1980), the Fifth Circuit explained the effect of Section 601:

> Section 601(a) of NGPA, 15 U.S.C.A. Section 3431(a), exempts certain categories of natural gas from the jurisdiction of FERC and the requirement of obtaining a certificate of public necessity under NGA . . . . It is clear from Section 601 that Congress intended to free certain natural gas from FERC jurisdiction, while leaving other gas subject to that jurisdiction.

Id. at 797, and 799.

In *Tenneco, Inc. v. Sutton*, 530 F. Supp. 411 (M.D. La. 1981), the District Court there succinctly summarized the effect of the NGPA:

> The NGPA is basically an overlay of the NGA since the NGA remains applicable to interstate transportation and interstate sales for resale, *unless a specific exclusion of the NGA jurisdiction is provided.* The NGPA eliminates many of the NGA's price and non-price producer regulations. Under the provisions of the NGPA, the NGA is inapplicable after November 3 1980 [sic], to first sales of natural gas which were not committed or dedicated to interstate commerce on November 8, 1978, and to first sales of committed or dedicated gas

> which have been determined to be new natural gas, new onshore production well gas, or within certain categories of high cost gas. *These provisions remove the Commission's authority to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipe line purchaser's pass-through of purchase gas costs.* These provisions also relieve producers of gas not committed or dedicated to interstate commerce and gas in the new natural gas and new onshore production well categories, from any requirement of receiving certification or abandonment authorization, or of making rate filings under the NGA.
>
> Impediments to producer sales into the interstate market of natural gas which was not committed to that market at the time the NGPA was enacted are eliminated.

Id. at 419. (Emphasis added)

These decisions are consistent with the legislative history and the clear wording of Section 601 of the NGPA; first sales of Section 107 High Cost Gas are removed from federal jurisdiction.

A thorough examination of Rule 48 as affected by the NGPA is given in Steven P. Williams' article, Federal Preemption of State Conservation Laws After the Natural Gas Policy Act: A Preliminary Look, 56 University of Colorado Law Review, pages 901-916. This article (which will be printed in August, 1985), presents a complete analysis of preemption, *Northern Natural* and state conservation laws after the NGPA. (The page cites for this article are from galley proofs and are tentative.) The ratable take order

rendered by the Mississippi State Oil and Gas Board seems consistent with the federal program, initiated in the NGPA:

> As construed by the court, the Mississippi Board's authority seems presumptively consistent with the federal program. It appears well designed to correct a potential market failure in sales of gas at the wellhead. The possible market failure arises from two sources. First, economics of scale make it probable that there will be only a few pipe line buyers in any one field (sometimes only one). Second, a producer without a purchaser suffers the risk, under the Rule of Capture, of seeing gas extracted from his property by fellow producers and sold without his realizing a nickle. As a result, monopsonistic or oligopsonistic pipe lines might manipulate producers and generate the standard consequences of monopsony or oligopsony: sales in lower quantity and at a lower price than would prevail under competitive conditions. Coupled with these effects is a distributional one, that the owner of the property interest in the gas would lose it without compensation (the problem of 'correlative rights'). The Mississippi Board's authority (as limited by the court) can be viewed as remedying the market failure with roughly the minimum feasible market distortions. The mandate of the Mississippi Board is evidently to mimic a market free of monopsony or oligopsony.

Id. at 908.

Professor Williams is very perceptive in his analysis. Transco and FERC are attempting to lead the country back into federal regulation which will assure the country of returning to the same gas shortage which occurred in the 1970's. When the only objective of the natural gas policy is to produce gas to the interstate market at the lowest price,

then the system won't work. Consideration must also be given to the exploration and production of those gas supplies. Without exploration and production there will be no future gas supplies. Take or pay contracts encourage exploration because it enables a producer to obtain financing for his exploration. A lender will be more likely to lend money if he can be assured that his borrower will be assured a steady income through take or pay contract provisions. Likewise, if an operator knows that he will have a market for any gas that he might discover (under ratable take rules or otherwise), then he will be more likely to risk the investment necessary to drill a well. He will be less likely to spend the money drilling a well if there is a possibility that the pipe line into the field will refuse, and be permitted to refuse, to provide him a market for his gas. In this case, the gas underlying his well will be drained to and produced by wells on adjoining land and he will not be able to recover his investment. Ratable taking under Rule 48 helps to ensure a healthy, competitive gas supply which is the policy manifested by the NGPA.

Considering the consistency of ratable taking and the goals evidenced by the NGPA, Professor Williams concludes that ratable take orders should not be preempted under Northern Natural:

> Adoption of the NGPA established as the longrun goal of federal natural gas policy the establishment of a competitive wellhead market free of price controls. Federal adoption of that goal undermines the premise of *Northern Natural* that any state action that risked increasing the price of natural gas for ultimate consumers was necessarily preempted. The primary standard should now be whether the state action is congruent with development of the sort of market that Congress sought to achieve.

Id. at 915-916.

C. Preemption Cases

In *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941), the Supreme Court stated that a state law is preempted if it "stands as an obstacle to the accomplishment of the full purposes and objectives of Congress." And in *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 236 (1947), the Court noted that the test of preemption is whether "the matter on which the State asserts the right to act is in any way regulated by the federal government." Here, it is the stated objective of Congress to increase the supply of gas in the interstate market by removing certain categories of gas from the web of FERC's jurisdiction. Congress has expressly removed from FERC's purview wellhead sales of deregulated gas.

Furthermore, Transco's assertion that Order No. 409-82 interferes with FERC's pervasive interest in regulation of the sale of natural gas in interstate commerce does not by itself lead to the conclusion that the Board is preempted from applying Rule 48 to an interstate gas pipe line. In *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375 (1983) 76 L.Ed.2d 1 (1983), AEEC and the United States, as *amicus curiae*, argued that the Arkansas PSC's assertion of jurisdiction interfered with the federal Rural Electrification Administration's "pervasive involvement in the management of the rural power cooperatives to which it loans funds, and may frustrate important federal interests." *Id.* at 11. The Court ignored this broad assertion and instead analyzed the true relation between the Rural Electrification Act and State regulatory jurisdiction over wholesale electricity rates as explained in the legislative history of that Act:

> Contrary to the suggestion in the dissent, we do not infer from this legislative history that Congress either

> 'authorized' or 'expected' state regulation that this Court had barred states from engaging in. [Citations omitted] The relevant inquiry, however, is not whether Congress authorized or expected such regulation, but whether it intended by its own actions to forbid it. Cf. *Pacific Gas & Elec. Co. v. State Energy Resources Development Comm'n*, 461 U.S. 190 (1983). In answering that question, we look quite naturally to whether Congress intended in any way to forbid state regulation of rural power cooperatives.

Id. at 12, n. 11.

Federal regulation of a field of commerce should not be deemed preemptive of state regulatory power unless either the nature of the regulation permits no other conclusion or Congress has made its intent to preempt state regulation unsuitably clear. *Florida Line and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142, (1963). A court cannot infer an intent to preempt merely from the comprehensive character of complex legislation. *New York State Department of Social Services v. Dubleno*, 413 U.S. 405, 415, (1973). Where an exercise by a state of its police power is attacked there is a presumption against a congressional intention to preempt in the absence of a clear and manifest expression by Congress favoring it, or an evident public purpose which would be forestalled were preemption not found to have occurred. *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 157, (1978). Nothing here suggests a manifest necessity for preemption, in fact, the contrary is true; the necessity in this case is no preemption and a viable market at the wellhead. *Penn Terra Limited v. Department of Environmental Resources, Commonwealth of Pennsylvania* 733 F.2d 267 (3rd Cir. 1984) is particularly pertinent to the applicability of preemption where vital interests such as the correlative rights of owners in a gas pool are involved:

> The police power of the several states embodies the main bulwark of protection by which they carry out their responsibilities to the people; its abrogation is therefore a serious matter. Congress should not be assumed, therefore, to have been miserly in its refund of that power to the States. Where important state law or general equitable principles protect some public interest, they should not be overridden by federal legislation unless they are inconsistent with explicit congressional intent such that the supremacy clause mandates their suppression.

Id. at 273

The message from Congress is not only clear, it is paramount: FERC's jurisdiction over Transco's field purchases of deregulated gas does not begin until after said gas has entered the transportation link of the interstate pipe line system. Since there is no jurisdiction, there is nothing to preempt, and Rule 48 an Order No. 409-82 do not violate the Supremacy Clause of the Constitution. *Northern Natural* no longer applies because it was undergirded by federal jurisdiction over first sales.

D. Additional Response to Claims in Transco and Amici Briefs

The foregoing argument should be determinative of the preemption question. However, there are specific assertions in the briefs of Transco and Amici which need to be answered.

When Transco cites *Arkansas Electric Cooperative Corporation v. Arkansas Public Service Commission* 461 U.S. 375 (1983), as holding that a federal decision not to regulate an area can have as much preemptive force as a decision to regulate, it incorrectly implies that this rule is applicable to the case at hand. In our case, Congress found that regula-

tion and price control of natural gas, which was established under the NGA regulatory scheme, has had the effect of stifling discovery and production for the interstate market. Congress determined that this effect could be reversed by initiating a different approach through federal deregulation of first sales of certain categories of natural gas. Furthermore, the Court in the case said, "the relevant inquiry, however, is not whether Congress authorized or expected such regulation, but whether it intended by its own actions to forbid it."

The ratable take provision involved in this case was simply not an issue in *Maryland v. Louisiana* 451 U.S. 724 (1981) and *Exxon Corporation v. Eagerton*, 462 U.S. 176 (1983). In those cases, Congress had not expressly removed the subject matter in issue from the ambit of FERC's regulatory power as it has here with respect to wellhead sales of deregulated gas.

Transco claims that Rule 48 and Order 409-82 is in conflict with ongoing FERC regulation of interstate pipelines which is in the form of an inquiry on possible discrimination of interstate pipelines. FERC has the authority under Section 601(C) (2) to deny Transco the right to pass through to its customers any costs that are "excessive due to fraud, abuse, or similar grounds". No doubt this is the basis upon which this inquiry is being made. If FERC determines that Transco's costs are excessive due to fraud, etc. then it can deny Transco the right to pass such excess through to its customers. In such case, Transco absorbs the excess. This power of FERC to determine whether costs are excessive does not give it any right to regulate the first sales of the gas which are expressly exempted by the act. The opinion in *Tenneco v. Sutton* 530 F.Supp. 411 (M.D. La. 1981), clearly states that FERC shall not have the authority to regulate pro-

ducer sales under the pass through jurisdiction of Section 601(C)(2):

> Under the provisions of the NGPA, the NGA is inapplicable after November 3, 1980 [sic], to first sales of natural gas which were not committed or dedicated to interstate commece on November 3, 1978, and to first sales of committed or dedicated gas which have been determined to be new natural gas, new onshore production well gas or within certain categories of high cost gas. *These provisions remove the Commission's jurisdiction to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipeline purchaser's pass-through of purchase gas costs.*

Id. at 419.

Professor Williams states, "The Commission, however, has read the legislative history as establishing that its 'fraud or abuse' power is not to be be a 'backdoor' for 'regulation' of wellhead prices". Williams, *supra* at 901 (citing Statement of Policy, Fraud, Abuse Standard in Section 601(C)(2) of the NGPA, 47 Fed. Reg. 6253 (Feb. 11, 1962), FERC Statutes & Regulations Par. 30, 336).

Transco's argument that ratable take orders relate to "transportation" jurisdiction under the NGA is not valid. If the transportation argument were accepted, "transportation" jurisdiction would engulf the sales activities and render FERC's NGA "Sales" jurisdiction mere surplusage, and would be inconsistent with Congress' removal of certain "first sales" from FERC's jurisdiction by the NGPA.

Finally, the Amicus Brief filed by Associated Gas Distributors cites that portion of *Northern Natural* which

states that the ratable take orders shift to the shoulders of the interstate purchasers the burden of balancing production between wells. This is not an undue burden. All the pipeline purchaser needs to do is read the flow charts which measure the flow of gas from each well. This is normally done on a monthly or semimonthly basis and the flow charts can be mailed to the purchaser's office. Likely, the purchaser is already checking these flow charts to make sure that it is not taking more gas than it intends. Professor Steven Williams notes that this burden is trivial. Williams, *supra.*

II. Rule 48 and Order No. 409-82 Do Not Violate the Commerce Clause

This Court has previously upheld state ratable take orders such as Statewide Rule 48 when those orders were challenged under the Commerce Clause. *Cities Service Gas Co. v. Peerless Oil and Gas Co.*, 340 U.S. 179 (1950). Moreover, the holding in Cities Service that a ratable take order does not violate the Commerce Clause was specifically approved in this Court's decision in *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963), upon which Transco relies so heavily in its jurisdictional statement. Nevertheless, Transco now asks this Court to ignore these precedents and find Statewide Rule 48 in violation of the Commerce Clause.

In *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), this Court set forth the following test to be applied in the Commerce Clause challenges:

> Where the statute regulated evenhandedly to effectuate a legitimate public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question

> becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Id. at 142.

Thus, applying the *Pike v. Bruce Church* test, a state regulation will be upheld where:

1. It regulates evenhandedly;

2. to effectuate a legitimate local public interest;

3. unless the burden imposed on interstate commerce is clearly excessive in relation to the putative local benefits;

4. the extent of the burden to be tolerated depends on whether the local interest could be promoted as well with a lesser impact on interstate activities.

The following discussion will consider each of these standards of the *Pike v. Bruce Church, Inc.* decision.

A. Rule 48 Regulates Evenhandedly.

Statewide Rule 48 does not discriminate against Transco or any interstate company in favor of Mississippi producers. This rule applies evenhandedly to all field producers of oil and gas, be they interstate pipeline or local oil purchasers. Furthermore, Statewide Rule 48 does not restrict the flow of natural gas into the interstate market, a result of state regulation which was condemned in *Pennsylvania v. West Virginia*, 262 U.S.. 553 (1923), where a West Virginia statute required domestic gas producers to supply local needs first before allowing the surplus gas, if any, into the interstate market. Nor does it threaten to withdraw large reserves of natural gas from the interstate market as did the

Oklahoma Corporation Commission's order in *FPC v. Corporation Commission*, 362 F.Supp. 522 (W.D. Okla. 1973), *aff'd.* 415 U.S. 961 (1974). The Commerce Clause was meant to protect against the burdens on interstate commerce condemned in the abovementioned cases, and not against state ratable take requirements.

On the contrary, Rule 48 is a uniform, evenhanded prohibition on discriminatory purchasing practices by purchasers from a pool. Any purchaser, whether interstate or intrastate in nature, is subject to Statewide Rule 48, regardless of the destination for which the gas is purchased. Rule 48 regulates evenhandedly and satisfies this part of the *Pike v. Bruce Church, Inc.* test.

B. Rule 48 Effectuates a Legitimate Local Interest

Rule 48 is necessary to protect the coequal and correlative rights of all owners in an oil or gas pool. If there are any two wells completed in a gas pool and a pipeline takes all of the gas produced from one well and refuses to take gas from the second well, then the owners of the first well obtain all of the production from the pool under the Rule of Capture. The owners of the second well get nothing. Rule 48 protects against this abuse of the rights of owners in the pool and is a proper exercise of the states police power. The protection of these rights is a legitimate local interest.

Ratable taking provided under Rule 48 promotes development of natural resources. If an operator is assured of an access to a market under Rule 48, if he does successfully complete a well in a gas pool, then he is more likely to take the risk in drilling the well and he is more likely to obtain financing for the drilling. If Rule 48 does not apply to the pipeline purchaser, and accessibility to a market for his production is at the fancy of the pipeline purchaser (which may prefer to take the gas from the reservoir from another

well completed in the pool), then the operator is less likely to drill the well and less likely to obtain the necessary financing. The development of a state's natural resources is a legitimate local interest (Rule 48 is also in the national interest since it promotes the development of oil and gas).

The state's exercise of its police power in promoting conservation of its natural resources by preventing waste and protecting correlative rights has long been recognized as a legitimate state interest. *Cities Service Co. v. Peerless Oil and Gas Co.* 340 U.S. 179 (1950).

C. The Burden Imposed on Interstate Commerce is Not Clearly Excessive in Relation to the Local Putative Benefits.

Transco says that if it is forced to comply with Rule 48, it will have to either (1) take more Section 107 High Cost Gas than it needs from Mississippi, or (2) reduce its takes of said gas in Mississippi from its contract sellers thereby incurring take or pay costs. Neither choice will impose an excessive burden.

These proceedings which commenced in 1982, involve deregulated Section 107 High Cost Gas. In 1981, this category of gas represented only one percent of the aggregate supply of gas in the United States. Pierce, Natural Gas Regulation, Deregulation and Contracts, 68 Va.L.Rev. 63 (1982) at page 87-88). This tiny fraction of the aggregate gas supply will have no significant, let alone "excessive" impact. Furthermore, the days of excessive gas supply are just about over. Gas is an exhaustible resource. The oversupply in the past was dissipated by the 1970's when a shortage occurred. The deregulation which resulted from the NGPA in 1978 increased drilling and additional gas reserves were discovered which resulted in the current gas glut. However, the current gas glut is estimated to end by 1990. Johnston,

Natural Gas Sales Contracts, 34th Institute on Oil & Gas Law, Southwest Legal Foundation 83 at 112. The problems that Transco perceives are but temporary, and this should be considered in deciding whether Rule 48 creates an excessive burden.

The concerns of Transco are discussed in 3a and 3b below.

C(1), Does Rule 48 Require Transco to Take More Mississippi Gas?

Transco contends that the enforceability of Rule 48, when combined with Mississippi's policy of setting a well's allowable based upon deliverability, results in an increase in the percentage of gas taken from Mississippi at the expense of other producing states. The analysis is not correct. Allowables for gas wells are based upon deliverability under Rule 33 of the State Oil and Gas Board. But the allowable merely establishes the maximum rate that a well is allowed to produce. A producer is not required to produce a well at the allowable, he is only prevented from producing at a rate in excess of the allowable. All Rule 48 states is that if a purchaser takes production from one well, it must take production from other wells at the same rate (i.e. at the same percentage of the well's allowable whether it be one percent, fifty percent or one hundred percent of the well's allowable). The purpose of Rule 48 is to protect against drainage between wells resulting from unratable taking between wells.

There is nothing in Rule 48 or Order 409-82 which will require Transco to take any gas in the East Morgantown and Green Creek Fields in Mississippi. Transco can take no gas from these fields and comply with Rule 48. All Rule 48 says is that if Transco takes gas from one well in a pool, then it must take a like percentage of a well's allowable from the other wells in the pool. Transco has total control on the amount of gas it takes from a pool. Consequently, Rule 48

does not require Transco to increase its takes from Mississippi at the expense of other producing states.

C(2). Rule 48 Does Not Cause an Excessive Burden on Interstate Commerce Through Increased Take or Pay Costs.

Transco contends that if it is forced to take ratably and does not increase its total takes to cover non-contract owners' gas, then it will have to reduce purchases from owners with whom it has gas sales contracts. This reduction will cause Transco to make take or pay payments if purchases with these owners drop below the take or pay limit. If this happens the take or pay payments will not be an excessive burden on interstate.

1. First it should be stated that Rule 48 has nothing to do with contract obligations which parties may incur. All Rule 48 says is that if you purchase from one party then you must make a market available to the other parties in the pool. Any take or pay obligations which pipeline purchasers incur are obligations which the purchasers impose upon themselves and are not imposd by Rule 48. Accordingly, any alleged take or pay burdens should not be attributed to Rule 48.

2. Transco should not be permitted to relieve itself of contractual obligations which were of its own making by hiding behind the Commerce Clause. Transco was aware of Rule 48 when it purchased gas in Mississippi and was aware that it was subject to it:

By Chairman Fancher

Q: Okay. Let me ask you a question. When Transco enters into a gas purchase contract, are they aware of Rule 48?

(Ms. Pollard): Yes, sir when we contract to buy gas

in any state, we buy it subject to the rules in the state . . .

By Chairman Fancher

Q: Yes, that's all very good, but what about ratable take without discrimination? When you come in here to purchase gas, don't you realize that your contract is subject, and your purchasing and your distribution and sale of gas is subject to Rule 48? If the rule is any good it's part of your contract, isn't it? Or at least your operations are subject to it, are they not?

A: That's correct. J.A. 139-40

Furthermore, Transco was aware that from time to time excess supply conditions would exist since that is the only situation which would make a take or pay clause necessary or applicable. Transco should not be permitted to unilaterally relieve itself of contractual obligations by hiding behind the Commerce Clause. This Court has numerous times held that the Commerce Clause does not protect interstate firms from the impact of state regulation where the flow of interstate commerce is not affected. *Minnesota v. Clover Leaf Creamery, 449 U.S. 456 (1981); Exxon Corporation v. Governor of Maryland,* 437 U.S. 117 (1978).

3. Take or pay clauses are a benefit to interstate commerce rather than a burden because it facilitates oil and gas operations and marketing of gas. Take or pay provisions provide that if a purchaser does not take a certain quantity of gas by a particular date, then it must pay for that quantity; it will have the right to make up that quantity in the future with no additional cost. This clause meets the needs of both the producer and the purchaser:

> Thus the 'take or pay' provision meets the needs of the producer for a steady minimum income to pay his operating costs, taxes and royalty, while at the same time allowing the pipeline flexibility in the operation of its system to meet periods of uneven demand caused by weather, economic conditions, etc. The small producer frequently borrows money to finance his exploration and development programs on the security of income from his producing properties. If that income is disrupted through the shutting in of his wells for reasons over which he has no control, he may quickly find himself in serious financial difficulty. The take-or-pay provision provides important safeguards which allow such producers to stay in business.

Johnson, Natural Gas Contracts, 34 Annual Oil & Gas Institute, 83 at 111.

Any provision which is beneficial to both producer and seller and which facilitates exploration is a benefit and not a burden on interstate commerce.

4. Take or pay costs are paid by the pipeline purchaser. When the pipeline later makes up the gas it does not have to pay for it again. All the pipeline is out is the use of the money paid for gas not taken between the time the money is paid and the gas is made up. Assuming the use of money is worth ten percent, then the real cost is only ten percent of the take or pay payment. It is submitted that cost which is passed on to the consumer is a reasonable cost and but a "fraction of the cost paid by domestic consumers at the burner tips" and therefore, *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) still applies.

5. Another reason that take or pay costs are reasonable is that take or pay costs are a necessary cost to obtain the gas. The gas contracts involved in this litigation were executed

during the gas shortage in the 1970-81 period. At that time Transco and other purchasers could not meet their customers needs. The seller was able to demand a high price for his gas and other contractual provisions such as take or pay clauses with high take requirements. The take or pay costs are part of the price necessary to obtain the gas and it is reasonable to pass it along to the consumer for whose benefit the gas was obtained. If those consumers will recall the hardships suffered during the gas shortage, they should be appreciative of what it took to obtain the gas. These costs were reasonable when the gas was acquired and passing these costs on to the consumer is a reasonable and not an excessive burden on interstate commerce. The Mississippi Court noted that higher purchasing costs at the wellhead leading to higher costs to the consumer is simply one inevitable consequence of the free market era of deregulation of the Commerce Clause. J.S. 38a.

6. Transco's argument that Statewide Rule 48 impermissably affects interstate commerce because it would result in higher prices to consumers is not determinative of the Commerce Clause question. First, higher prices to consumers in another state do not render a state's regulation of commerce impermissable under the Commerce Clause. *Cities Service Company v. Peerless Oil and Gas Co.*, 340 U.S. 179, 186-87 (1950). Secondly, Congress has declared that all reasonable costs of production of deregulated natural gas shall be borne ultimately by the consumer. This is one of the fundamental policy determinations underlying the Natural Gas Policy Act of 1978. *See, e.g. Public Service Commission v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) (costs of providing production and incentives are plainly to be shouldered by down stream consumers, not pipelines). Thus, as pointed out by the Mississippi Supreme Court in its decision herein, "whether increased prices to consumers may be

fairly characterized as an incidental burden upon interstate commerce, we find it persuasive that Congress within the scope of its power under the affirmative Commerce Clause has expressly authorized its increases." J.S. 36a; *See also*, Steven Williams' article in 56 Univ. Colo. L.Rev 601, *supra*, (where he states that because of the NGPA's commitment to the ultimate establishment of a healthy competitive market at the wellhead, one may impute to Congress an intent that well-designed, market mimicking ratable take orders should now survive, notwithstanding some minor price burdens on consumers).

7. Moreover, the burdens on interstate commerce caused by Statewide Rule 48 as set forth by Transco are in reality, nothing but speculative and hypothetical examples of an imagined burden on interstate commerce, and such speculative and hypothetical possibilities are not sufficient to challenge a state regulation under the Commerce Clause. *Arkansas Electric Cooperative Corporation v. Arkansas Public Service Commission*, 461 U.S. 375 (1983). There is no proof in the record of actual burdens.

Based upon the foregoing, it is submitted that the take or pay obligations of Transco are not an unreasonable burden on interstate commerce.

D. Can the Burden be Promoted as Well With a Lesser Impact on Interstate Commerce?

Transco contends that Mississippi has a constitutional alternative to Rule 48 in that it can regulate the producer rather than the purchaser. This is not a practical solution. Mississippi can tell the producers to produce ratably, but if the pipeline won't take ratably, there will be no ratable production. The pipelines control production. Once gas comes out of the wellhead its only outlet is a pipeline to carry it to market. If a pipeline purchaser shuts its valve and does

not take a well's production, there is no way that well can produce without venting the gas into the atmosphere. The pipeline is the key player and must be subject to the Oil and Gas Board's jurisdiction to insure ratable taking.

Furthermore, as pointed out in the opinion of the Mississippi Supreme Court:

> The search for such alternatives, however, need not be made in connection with our Commerce Clause inquiry until it first be established that the regulation in question creates an unreasonable burden on commerce. This Transco has failed to do - for as explained above, the burdens are on Transco, not interstate pipelines generally, because only Transco has, wittingly or unwittingly, bound itself to a long term, fixed price gas purchase contract. When that contract is taken out of the case, it is seen that the so called burdens of Rule 48 disappear.

Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board, 457 So.2d 1298, 1323 (Miss. 1984).

In summary, Transco has failed to show that the burden imposed upon interstate commerce by enforcement of Rule 48 is "clearly excessive in relation to the putative local benefits." Rule 48 is not in violation of the Commerce Clause. Attached as appendix A is a decision of the Oklahoma Corporation Commission which reaches the same result.

CONCLUSION

Rule 48 and Order No. 409-82 are fair and promote development of oil and gas in Mississippi. These are beneficial for the State of Mississippi and are consistent with national interests. The protection of the correlative rights of owners in oil and gas reservoirs applies to non-resident owners as well as resident owners. Oil and gas production benefits the nation as well as the states. Rule 48 does not produce the type of local prejudice that the Commerce Clause and the Supremacy Clause were designed to prevent.

Transco's claims and the authorities it cites arise from a past era when the nation's gas supply seemed inexhaustible. At that time it was possible to be concerned only with setting artificially low prices for consumers. The prevailing regulatory scheme at that time did not need to take into account what was necessary for a viable supply of gas and it did not. The shortsightedness of that regulatory policy resulted in decreased exploration and a shortage of gas supplies in the interstate market.

With the national gas shortage of the seventies the whole regulatory concept had to be reexamined. Congress realized that consideration had to be given to the supply side so that sufficient gas would be available to the national market. This was accomplished through deregulation as manifested in the Natural Gas Policy Act of 1978. With it came deregulation of first sales of Section 107 High Cost Gas, and also the realization that in order to obtain sufficient gas supplies the consumer would have to pay increased cost. This new policy brought the demise of old concepts of the Commerce Clause and preemption under the Supremacy Clause.

This case is a manifestation of the new era implemented by the NGPA. Rule 48 and orders implemented under it are viable and within all constitutional limits.

For these reasons, the judgment below should be affirmed.

Respectfully submitted,

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APPENDIX

APPENDIX A

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN RE: WHETHER THE OKLAHOMA CORPORATION COMMISSION HAS THE AUTHORITY TO REQUIRE RATABLE TAKE OF NATURAL GAS BY FIRST PURCHASERS WHO ARE INTERSTATE PIPELINES.	**General Cause No. 28770** **Order No. 281285**

ORDER DETERMINING AUTHORITY OF THE COMMISSION TO REQUIRE RATABLE TAKES OF NATURAL GAS BY FIRST PURCHASERS WHO MAY BE INTERSTATE PIPELINES

I.
PROCEDURAL HISTORY

On January 9, 1984, the Oil and Gas Conservation Division of the Corporation Commission filed a Notice of Inquiry and Motion to Consolidate Causes as a result of numerous causes filed pursuant to 52 O.S. 1981, § 240, and rules promulgated thereunder. Exhibit "A" attached hereto and incorporated herein lists the pending causes. The Commission en banc heard oral argument on said motions and issued Order No. 254451 on February 27, 1984, which consolidated the causes and divided them into two phases, the first phase involving a review of Commission jurisdiction and the second phase to separate and continue any further proceedings on an individual case basis. In addition, Order No. 254451 set forth a briefing and oral argument schedule and established a hearing panel to take evidence and to consider the following issues common to the consolidated causes:

1. Is the State of Oklahoma preempted by the Commerce Clause of the United States Constitution from enforc-

ing the requirements of 52 O.S. 1981, § 240, requiring the ratable taking of gas against interstate pipelines which are the first purchasers of Oklahoma-produced natural gas?

2. Does the Federal Energy Regulatory Commission under the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978 have sole authority over the regulation of gas purchases by interstate purchasers of natural gas thereby preempting the State of Oklahoma from acting under 52 O.S. 1981, §§ 239 and 240?

Order No. 254451 was published as required by law and the rules of the Commission. Procedural directives regarding the filing of briefs, notices of intention to participate and scheduling of oral arguments were issued by the hearing panel on May 3, 1984, and May 17, 1984. Oral argument was had before the hearing panel on May 21, 1984, at which time all interested parties had an opportunity to present testimony. On September 4, 1984, the report of the hearing panel issued recommending that the issues presented to them be answered in the negative. The report was filed with the Secretary of the Commission on September 7, 1984. Exceptions and written comments were filed and oral argument was had before the Commission sitting en banc on October 17, 1984, at the close of which the cause was taken under advisement. By the filing of briefs or an entry of appearance or by an entry of appearance made at the time of oral argument, some 113 parties participated in this cause as listed on Exhibit "B" to this order. The parties will hereinafter be referred to as "Proponents" (those arguing in favor of Commission jurisdiction) and "Opponents" (those in opposition to Commission jurisdiction).

The Commission is aware that numerous authorities have been cited in support of each position and has addressed herein those most frequently cited or most supportive of the respective positions. All issues have been exhaustively briefed and argued and the Commission appreciates the efforts of all participants.

II.
OKLAHOMA STATUTORY SCHEME AND COMMISSION RULES PROMULGATED THEREUNDER

The focus of Commission inquiry in this matter is on 52 O.S. 1981, §§ 239 and 240 (hereinafter Section 239 and Section 240). These statutes were enacted in 1915 and have not been amended. Sections 239 and 240, provide as follows:

> SECTION 239. Whenever the full production from any common source of supply of natural gas in this state is in excess of the market demands, then any person, firm or corporation, having the right to drill into and produce gas from any such common source of supply, may take therefrom only such proportion of the natural gas that may be marketed without waste, as the natural flow of the well or wells owned or controlled by any such person, firm or corporation bears to the total natural flow of such common source of supply having due regard to the acreage drained by each well, so as to prevent any such person, firm or corporation securing any unfair proportion of the gas therefrom; provided, that the Corporation Commission may by proper order, permit the taking of a greater amount whenever it shall deem such taking reasonable or equitable. The said commission is authorized and directed to prescribe rules and regulations for the determination of the natural flow of any such well or wells, and to regulate the taking of natural gas from any or all such common sources of supply within the state, so as to prevent waste, protect the interests of the public, and of all those having a right to produce therefrom, and to prevent unreasonable discrimination in favor of any one such common source of supply as against another.
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> SECTION 240. Every person, firm or corporation, now or hereafter engaged in the business of purchasing and selling natural gas in this state, shall be a common purchaser thereof, and shall purchase all of the natural gas which may be offered for sale, and which may reasonably be

reached by its trunk lines, or gathering lines without discrimination in favor of one producer as against another, or in favor of any one source of supply as against another save as authorized by the Corporation Commission after due notice and hearing; but if any such person, firm or corporation, shall be unable to purchase all the gas so offered, then it shall purchase natural gas from each producer ratably. It shall be unlawful for any such common purchaser to discriminate between like grades and pressures of natural gas, or in favor of its own production in which it may be directly or indirectly interested, either in whole or in part, but for the purpose of prorating the natural gas to be marketed, such production shall be treated in like manner as that of any other producer or person, and shall be taken only in the ratable proportion that such production bears to the total production available for marketing. The Corporation Commission shall have authority to make regulations for the delivery, metering and equitable purchasing and taking of all such gas and shall have authority to relieve any such common purchaser, after due notice and hearing, from the duty of purchasing gas of an inferior quality or grade.

On October 19, 1983, this Commission promulgated rules pursuant to these sections, effective January 1, 1984, which established a priority schedule for takes of natural gas where a supply and demand imbalance is present within a first purchaser's system within the State of Oklahoma. At the hearing before the panel of hearing officers on May 21, 1984, the panel ruled that reference could be made to the "Priority Rules" within the context of arguments on the constitutional issues since the priority rules (1) are an example of the type of authority the Commission seeks to assert over interstate pipelines; (2) were promulgated under the authority of Sections 239 and 240, which statutes are here the subject of constitutional inquiry; and (3) are final and unappealable. A copy of the final rules is attached hereto as Exhibit "C" and incorporated herein.

III.
ARGUMENTS AND AUTHORITIES

Is the State of Oklahoma Preempted by the Commerce Clause of the United States Constitution from Enforcing the Requirements of 52 O.S. 1981, § 240, Requiring the Ratable Taking of Gas Against Interstate Pipelines Which are the First Purchaser of Oklahoma-Produced Natural Gas?

Opponents argue that Commission regulation of pipeline takes will impermissibly burden interstate commerce for the reasons that prices of natural gas will increase, costs of administration, construction, and operation will increase and contractual obligations will be impaired. Further, opponents believe that these statutes are discriminatory and protectionist in nature which are prohibited by the Commerce Clause, relying primarily on *Hughes v. Oklahoma*, 441 U.S. 322 (1979); *Philadelphia v. N.J.*, 437 U.S. 617 (1978); *H. P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525 (1949); *Tenneco, Inc. v. Sutton*, 530 F. Supp. 411 (D.C. La. 1981); and *Federal Power Commission v. Oklahoma Corporation Commission*, 362 F.Supp 522 (W.D. Okl. 1973), aff'd, 415 U.S. 961 (1974). In *Hughes v. Oklahoma*, *supra*, the Supreme Court found an Oklahoma statute which provided that no person could "transport or ship [minnows] . . . for sale outside the state" violative of the Commerce Clause for the reason that the statute on its face discriminated against interstate commerce and that a legitimate local purpose was not ascertainable, reversing a previous position concerning wild animals and fish. 441 U.S. at 335-339. Likewise, a New Jersey statute prohibiting the importation of "solid or liquid waste which originated or was collected outside the territorial limits of the state . . ." was held to be violative of the Commerce Clause in *Philadelphia v. N.J.*, *supra*, for its discriminatory effect and its attempt to protect the State from the common problem of waste. 437 U.S. at 618. In *H.P. Hood & Sons v. Dumond*, *supra*, the Court found that a New York statute as applied to the licensing of milk distributors was

offensive to the Commerce Clause in that the purpose was to promote the State's economic advantage by curtailing interstate commerce. In *Tenneco v. Sutton, supra*, the Court found, inter alia, that Louisiana's statutes and regulations governing the offer to purchase gas by local users before it is offered to interstate users was clearly economic protectionism with no legitimate local purpose. 530 F. Supp. at 440. Finally, an Order by the Oklahoma Corporation Commission setting a minimum price level for natural gas was found to be protectionist in *Federal Power Commission v. Corporation Commission, supra*, as the purpose was not to prevent waste or protect correlative rights. 362 F. Supp. at 538. These cases clearly establish that a legitimate local interest must be the basis for a nondiscriminatory statute that effects interstate commerce and that such interest must outweigh any burden placed on interstate commerce.

Proponents argue that the exercise of state regulation over pipeline takes is constitutionally permissible in that the impact on interstate commerce is merely incidental. In addition, it is argued that the Oklahoma ratable take provisions are essentially directed toward the production of natural gas, an activity that is not considered interstate commerce. Finally, reliance is placed on *Cities Service Gas Company v. Peerless Oil and Gas Company*, 340 U.S. 197 (1950), (hereinafter "*Peerless*") in which the United States Supreme Court held that orders of the Oklahoma Corporation Commission setting natural gas prices and directing an interstate pipeline to make a well connection and take ratably pursuant to Section 240 did not impermissibly burden interstate commerce.

DISCUSSION

All parties agree that the general test for determining whether or not a state statute impermissibly impacts interstate commerce has been set forth in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), wherein the United States Supreme Court stated:

> Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. *Huron Cement Co. v. City of Detroit*, 362 U.S. 440, 443, 80 S.Ct. 813, 816, 4 L.Ed.2d 852. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

With regard to the first prong of the test under *Pike*, whether the statute is discriminatory, a plain reading of Section 240 demonstrates that all pipelines are subject to its terms "[w]henever the full production from any common source of supply of natural gas in this state is in excess of the market demands . . . " Section 239. It must be emphasized that Section 240 does not stand alone in its application; that it must be read in conjunction with Section 239 as a means for accomplishing the state's objective.

Section 239 sets forth circumstances for the allocation and regulation of the production of natural gas when supply exceeds demand. In addition to regulating the flow of production, another means for accomplishing the objectives explicitly authorized by Section 239 is to regulate the taking of natural gas from a common source of supply. The latter method of regulating production is more fully discussed in Section 240 which provides guidelines for the regulation of takes. The Commission's exercise of jurisdiction over interstate pipelines is therefore incidental to its jurisdictional mandate to regulate production pursuant to Section 239 and a tool for enforcing such production regulation.

The next prong of the test to determine whether these state statutes contravene the Commerce Clause is to identify a "legitimate local public interest" to which the regulation is directed. The state's exercise of its police power in promoting conservation of its natural resources by preventing waste and protecting correlative rights has long been recognized as a legitimate state interest. *See, generally, Peerless*, ("That a legitimate local interest is at stake in this case is clear. A state is justifiably concerned with preventing rapid and uneconomic dissipation of one of its chief natural resources.") 340 U.S. at 187; *Champlin Refining Co. v. Corporation Commission*, ("In Oklahoma, as generally elsewhere, landowners do not have absolute title to the gas and oil that may permeate the surface. These minerals, differing from solids in place such as coal and iron, are fugacious and of uncertain movement within the units of the pool. Every person has the right to drill wells on his own land and take from the pools below all the oil and gas that he may be able to reduce to possession including that coming from land belonging to others, but the right to take and thus acquire ownership is subject to the reasonable exertion of the power of the State to prevent unnecessary loss, destruction, or waste and that power extends to the taker's unreasonable and wasteful use of natural gas pressure available for lifting oil to the surface and the unreasonable and wasteful depletion of a common supply of gas and oil to the injury of others entitled to resort to and take from the same pool." [citations omitted]) 286 U.S. 210 at 233-234 (1932); *Walls v. Midland Carbon Co.*, ("The determining consideration is the power of the state over, and its regulation of, a property in which others besides the companies may have rights and in which the state has an interest to adjust and preserve, natural gas being one of the resources of the state. And this consideration it is more important to consider not for what a particular owner uses the gas, but the proportion of his use to that of others; or it may be, the prevention of use by others;") 254 U.S. 300 at 319 (1920).

Having established a legitimate local interest, the remaining prong of the *Pike* test focuses on the degree of burden which is

placed on interstate commerce by the state regulation. It is contended by some proponents that a producer's ability and right to produce gas always has an incidental effect on the purchaser's takes. Likewise, the supervision of those takes as a necessary means of regulating production incidentally affects interstate commerce. However, opponents believe that the burden of complying with Oklahoma's ratable take requirements directly interferes with interstate commerce.

In response to these contentions, and in support of Commission jurisdiction, proponents note that interstate pipelines presently maintain records and conduct operations in conformity with special allocated gas pool field-wide rules similar to what would be required for compliance with prorated takes. While opponents appear to speculate as to imagined burdens of costs and operational responsibilities, one interstate pipeline represented that it had adopted on its own initiative a ratable take procedure which has not burdened the company nor interstate commerce.

Opponents also allege that natural gas prices will increase as a result of increased construction and operational costs as well as contractual liabilities and obligations, thereby burdening interstate commerce. It is noted that the Commission has always had jurisdictional supervision over the construction and operation of gathering lines of interstate pipelines pursuant to the Natural Gas Act of 1938 (hereinafter NGA). In fact, the Federal Energy Regulatory Commission (hereinafter FERC) has formulated various tests to apply to pipelines in determining whether they are subject to the jurisdiction of the NGA. *See, e.g., Phillips Petroleum Company,* 10 FPC 246, 277 (1951), rev. on other grounds, 347 U.S. 672 (1954) ("behind the plant" theory); *Barnes Transportation, Inc.*, Opinion No. 306, 18 FPC 369 (1957) ("central point test") and *Ben Bolt Gathering Compamy,* 26 FPC 825 (1961), aff'd., 323 F.2d 610 (5th Cir. 1963) ("primary function" test). If exempted pursuant to Section 1(b) of the NGA, 15 U.S.C. § 717(b), this Commission may exercise its jurisdiction over the construction and operation of

the pipeline. Of course, any proposed construction or service of an interstate pipeline would require certificated approval by the FERC prior to the commencement where the costs would be subject to scrutiny as to their reasonableness by that agency. The Commission is unpersuaded that the speculative costs constitute an impermissible burden as companies are often required to expend large sums of money to comply with governmental regulations.

Opponents also contend a burden is placed on interstate commerce by the possibility that an interstate pipeline may incur contractual liabilities ("take or pay" obligations) as a result of state regulation. It is also argued that a pipeline's average cost of gas will be increased for the reason that the price of noncontractual parties' gas will be higher, thereby burdening interstate commerce. Proponents counter argue that any contractual liability would be suspended and superseded by state law, thereby alleviating any direct burden on interstate commerce. Proponents also contend that the cost of gas is not an issue as the NGPA has statutorily set price ceilings on natural gas or deregulated certain categories, requiring the FERC to investigate only those circumstances involving misrepresentation of the price paid or abuse rising to the level of "reckless disregard" in its ratemaking practices. Further, it is asserted by proponents that pipelines would not be required to take gas in excess of their market demand as contended and would, indeed, have flexibility in their purchase patterns as reflected in the priority schedule of Rule 1-305, Exhibit "C", attached hereto.

The Commission recognizes that some interstate pipelines are presently exposed to liability under existing contractual obligations and that this liability is frequently at issue in pipeline rate cases and rulemakings before FERC, in state and federal courts and in private settlement discussions. The Commission is reluctant, however, to project an economic scenario based on hypothetical fears on which to rest its decision. Rather, the Commission is of the opinion that it is, in fact,

exercising incidental jurisdiction over takes of gas while regulating production and furthering the legitimate state interest in protecting correlative rights and preventing waste. When applying the *Pike* test to the instant situation, it appears the weight of the scales is toward the exercise of the state's police power over production and enforcement thereof through the prorationing of takes. There is no method of promoting the state's interest which would have a lesser impact on interstate activities and to conclude otherwise would subject the state's power to protect its interest to that of private contracting practices.

Opponents' contention that these statutes are protectionist in nature must be rejected as there is no evidence that this state is placed in a position of economic isolation, enhancing its economy while depriving a sister state of economic benefits. The United States Supreme Court has noted that ". . . a state law constitutes 'economic protectionism' on proof either of discriminatory effect, *see Philadelphia v. New Jersey*, or of discriminatory purpose, *see Hunt v. Washington Apple Advertising Comm'n*, 432 U.S., at 352-353", *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 at 471 (1981). The record contains no evidence of either situation. Indeed, the statutes apply to both interstate and intrastate pipelines which precludes claims of discrimination and protectionism.

Proponents also rely on the *Peerless* decision as being persuasive in light of the Court's consideration of the Commerce Clause challenge to Sections 239 and 240. We are mindful that the Court's analysis of the State's order setting prices is no longer valid under *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), but believe that the Court's analysis of the state's conservation measures as determined by the Legislature in enacting Sections 239 and 240 is precedential.

In *Peerless*, the Supreme Court reviewed the Oklahoma statutory scheme and agreed with the Oklahoma Supreme Court that Sections 239 and 240 did not violate the Commerce Clause of the Federal Constitution. 340 U.S. at 184-185. It

recognized that ". . . a state may; adopt reasonable regulations to prevent economic and physical waste of natural gas," noting that "[t]his Court has upheld numerous kinds of state legislation designed to curb waste of natural resources and to protect the correlative rights of owners through ratable taking (citations omitted)." 340 U.S. at 185. The Supreme Court's consideration and constitutional pronouncement regarding the Oklahoma statute does lend support for its validity.

And, finally, proponents contend that the proposed regulation is an incident of production and not part of interstate commerce. *See, Champlin Refining Co. v. Corporation Commission, supra* at 236. While opponents disagree, it seems only logical that when production is dictated by pipeline capacity and demand and limited by this agency's setting of an allowable, the pipeline must be an integral part of that production function and regulation. Section 239 sets forth the circumstances under which prorating occurs and Section 240 provides a means of enforcing proration requirements. In this regard, the exercise of jurisdiction over interstate pipelines is incidental to this Commission's statutory responsibilities to protect correlative rights and prevent waste, a function of the regulation of production. As such, any incidental effect on interstate pipelines and interstate commerce is permissible.

IV.
ARGUMENTS AND AUTHORITIES

Does The Federal Energy Regulatory Commission Under The Natural Gas Act Of 1938 And The Natural Gas Policy Act Of 1978 ("NGPA") Have Sole Authority Over The Regulation Of Gas Purchases By Interstate Purchasers Of Natural Gas Thereby Preempting The State Of Oklahoma From Acting Under 52 O.S. 1981, §§ 239 And 240.

Opponents contend that the regulation of pipeline takes interferes with the regulatory scheme established by the NGA and NGPA which is administered by the FERC. In particular, it is alleged that state regulation of pipeline takes is prohibited

in that the FERC has exclusive jurisdiction over the sale and transportation of natural gas. It is contended that requiring ratable takes by pipelines would affect the price of that gas and certificated services which jurisdiction is exclusively that of the FERC. Reliance is placed on *Northern Natural Gas Co. v. State Corporation Commission of the State of Kansas*, 372 U.S. 84 (1963), (hereinafter "*Northern Natural*") in which the United States Supreme Court held as void an order of the Kansas Corporation Commission requiring a gas pipeline purchaser to take ratably from all producers supplying it with gas from a common source of supply. Other authorities which opponents cite to support their preemptive view are *Public Service Commission of the State of New York v. Mid-Louisiana Gas Company*, 463 U.S. 319, (1983); *Exxon Corporation v. Eagerton*, 462 U.S. 176 (1983); *Maryland v. Louisiana*, 451 U.S. 725, (1981); *California v. Southland Royalty Company*, 436 U.S. 519, (1978); *Tenneco, Inc. v. Sutton, supra.*

Public Service Commission of the State of New York v. Mid-Louisiana Gas Company, supra, involved a review of two orders promulgated by the FERC. The first order defined "first sale" pursuant to the NGPA as applied solely to interstate pipeline sales of natural gas and commingled independent-producer and pipeline-producer gas sales. The second order promulgated regulations under the NGA setting prices for pipeline production. The Supreme Court reviewed the natural gas regulatory pricing history and philosophy finding that:

> The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called "first sales" of natural gas. 463 U.S. at 331.

After a review of NGPA provisions and congressional intent, the Court concluded that the FERC orders pricing pipeline production differently than other production were "inconsistent with the statutory mandate (and would) frustrate the

policy that Congress sought to implement." [citation omitted]. This case is instructive insofar as explaining the effect of the NGPA on the first sale of natural gas.

An Alabama statute which prohibited oil and gas producers from passing through severance tax increases to purchasers was held preempted by federal law as to the sale of gas in interstate commerce in *Exxon Corporation v. Eagerton, supra*. The statute also prohibited producers from passing the 2% tax increase through to consumers and exempted royalty owners from the percentage tax increase which the Court found permissible under the NGPA. This case illustrates the limitation of a state's direct imposition of price regulation on interstate commerce versus its ability to regulate the intrastate market. Likewise when Louisiana imposed a "first use" tax on gas imported into the State from principally the Outer Continental Shelf, the Supreme Court held the law unconstitutional as violative of the Supremacy and Commerce Clauses. *Maryland v. Louisiana, supra*. After considering various procedural aspects, the Court found that "the effect of § 1303C (part of First-Use Tax) is to interfere with the FERC's authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers." 451 U.S. at 749. The Court's concern was that the one effect of the tax was to preclude FERC approval of expenses. 451 U.S. 750.

California v. Southland Royalty Company, supra, upheld a Federal Power Commission ("FPC," predecessor to FERC) order which found that gas dedicated to interstate commerce could not be diverted to the intrastate market without authorization of abandonment of service. This case was decided without consideration of the NGPA, but is a good review of the FPC's jurisdiction under the NGA. However, the exclusive authority of the FERC to regulate certificated service is not in question in this matter—only the ability of the state to regulate production through prorationing of takes.

The Louisiana statutes granting preferential treatment to Louisiana users and consumers were found to be preempted by

the NGA and NGPA in *Tenneco, Inc. v. Sutton, supra*, for the reasons that there was a direct conflict with federal statutory provisions and the purposes and objectives of the NGPA and NGA were frustrated. 530 F. Supp. at 437-438. This conclusion was reached after a consideration of the congressional histories of the federal acts and an extensive review of the caselaw. Opponents' authorities support the proposition that direct regulation of the transportation and sale of natural gas in interstate commerce is impermissible. However, it is contended that the Oklahoma statutory scheme does not directly regulate these areas.

Proponents assert that Oklahoma's ratable take statutes are directed toward the "production or gathering of natural gas" within the 1(b) exemption of the NGA, 15 U.S.C. § 717(b), and not to the transportation or sale of natural gas. Further, proponents contend that the passage of the NGPA has increased state regulation of oil and gas and eliminated any previously existing federal preemption. They further contend that the holding in *Northern Natural* has been eroded in light of the passage of the NGPA and that state and federal regulation of different aspects of an interstate pipeline in permissible. Support for these positions is primarily placed on *Public Service Commission of New York v. Mid-Louisiana Gas Co.*, discussed *supra; Tenneco, Inc. v. Sutton*, discussed *supra; Penzoil Company et al. v. FERC*, 645 F.2d 36 (5th Cir. 1981); *Mobil Oil Exploration and Producing Southeast, Inc.*, FERC Docket No. CI 77-41000, 18 FERC § 61,266 (1982).

The Court in *Penzoil Co. v. F.E.R.C., supra*, addressed the issue "[m]ay 'area rate clauses' in existing interstate gas purchase contracts escalate the contract price to the maximum lawful price provided in the Natural Gas Policy Act of 1978?" 645 F.2d at 365. The Court reviewed the NGPA and the Commission's responsibilities thereunder and upheld the FERC's orders permitting price escalation. Proponents have cited this case in support of their position that the NGPA has altered the regulatory outlook of the FERC.

Of particular interest is *Mobil Oil Exploration and Producing Southeast, Inc., supra*, in which the FERC reviewed relevant caselaw and commented on the agency's position concerning the 'production and gathering exemption', concluding:

> [I]t is clear that the production and gathering extends to the physical activities and processes involved in producing and gathering gas, as well as to the properties and facilities used in production and gathering. Congress left to the states the power to regulate these areas in order that the states could further their own legitimate interests in such matters as the conservation of their natural resource supplies, the prevention of waste, the economical and efficient development of their mineral resources, and the protection of the correlative rights of individual mineral interest owners. 18 FERC § 61,266.

In determining whether a state law is preempted by federal law, one must "start with the assumption that the historic police powers of the states were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977), quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Thus, where Congress explicitly states its intention to preempt state regulation in a specific area, or a "scheme of federal regulation [is] so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it," state regulation is barred. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. at 230. A review of the federal regulatory scheme demonstrates no express prohibition against state regulation of gas purchased by interstate pipelines as an incident of discharging the state's recognized interest in regulating production. It is also believed that the exercise of state and federal jurisdiction can coexist and work harmoniously as different aspects of the pipeline's business activities are regulated. The primary objective in resolving preemption issues is to attempt to accommodate state and federal interests. A re-

view of the federal regulatory framework should assist this analysis.

The NGA conferred authority on the FPC to regulate natural gas companies engaged in the construction of facilities and transportation and sales of natural gas in interstate commerce. FPC jurisdiction was expanded to include regulation of producer sales to pipelines of natural gas prices pursuant to *Phillips Petroleum Company v. Wisconsin, supra.* Congress expressly provided that the NGA would not apply to "any other transportation or sale of natural gas or to local distribution of natural gas or to the facilities used for such distribution or to the production and gathering of natural gas." 15 U.S.C. § 717(b). Therefore, federal jurisdiction under the NGA and *Phillips* was primarily directed toward the construction of facilities and transportation, sale and price of natural gas. As a result of a bifurcated gas market and inadequate interstate supply of gas, Congress enacted the NGPA which categorized natural gas and established a statutory maximum lawful price for certain categories, while deregulating others. *See, Tenneco, Inc. v. Sutton, supra,* at pages 418-420, for an overview of the NGPA. The establishment of statutory rates had the effect of supplanting FERC's "authority to establish rates for the wholesale market." *Public Service Commission of the State of New York v. Mid-Louisiana Gas Company, supra,* at 331. The statutory price paid for natural gas is deemed just and reasonable. *See,* 15 U.S.C. § 343 1(b)(1)(A); *Public Service Commission of New York v. Mid-Louisiana Gas Co., supra,* at 334.

While it is clear that the establishment of just and reasonable rates over the construction and transportation of natural gas and sale to its customers by interstate pipelines is an exclusive area reserved to the FERC, it is certain that Congress did not intended FERC to regulate production through requiring ratable takes by pipelines. Although the Court in *Northern Natural* explicitly rejected the application of the "production and gathering" exemption to those set of facts, the invalidation of Kansas' common purchaser statutes rested on other grounds.

One learned commentator has suggested that the Court was primarily concerned with the effect that the ratable take order could have on the price of gas to the consumer as "the fundamental purpose of FPC jurisdiction to regulate the sale of gas at the wellhead is to control prices for the benefit of the ultimate consumer." Meyers, "Federal Preemption and State Conservation in Northern Natural Gas," 77 Harvard Law Review 689 at 696 (1964). As proponents have pointed out, the federal regulatory focus has shifted from consumer protection to establishing price incentives for the exploration and development of natural gas reserves. In addition, the issue in *Northern Natural* was not whether the state had the power to regulate, but whether "the particular means chosen . . . threaten effectuation of the federal regulatory scheme." *Northern Natural, supra,* at 93. *Northern Natural's* precedential value is therefore questionable in light of the passage of the NGPA.

However, preemption may also be inferred when "compliance with both federal and state regulations is a physical impossibility." *Florida Lime and Avocado Growers v. Paul,* 373 U.S. 132, 142-143 (1963). Opponents complain that compliance would be burdensome and that there may be conflicts with certificated service, but the circumstances here do not reveal that compliance with the federal and state requirements would be a "physical impossibility." Both the state and federal regulatory schemes contemplate the exercise of independent business judgment by the regulated in managing their business while complying with the applicable laws. Any hypothetical conflict of state and federal law can either be avoided by prudent management or encouraged by deliberate actions. However, the Commission believes that proper planning in the decision-making process of this regulated industry will result in the accommodation of all interests.

And, finally, "preemption of a state statute may be found when that statute stands as an obstacle to the accomplishment of the full purposes and objects of Congress." *Jones v. Rath Packing Co.,* 430 U.S. at 526, 540-41, quoting *Hines v.*

Davidowitz, 312 U.S. 52, at 67 (1941). It is claimed that the Oklahoma statute intrudes upon the exlusive federal jurisdiction over interstate pipelines and their practices, but this proposition must be rejected. The FERC's responsibility to determin just and reasonable prices over the "first sale" of natural gas has been replaced by categorical price ceilings on natural gas. Congressional objectives have changed since the passage of the NGPA to encourage exploration for, and development of, natural gas reserves. In this regard, the Oklahoma statutes complement the federal objective as they attempt to prevent waste, thus preserving natural gas for the future.

The Oklahoma Supreme Court has stated on several occasions that this Commission "may employ such means as may be reasonably necessary to accomplish the declared purposes" of Section 239. *See, Corporation Commission v. Phillips Petroleum Company*, 536 P.2d 1284 (Okl. 1975); *Choctaw Gas Company v. Corporation Commission*, 295 P.2d 800 (Okl. 1956). The establishment of priority rules and enforcement of ratable take provisions of Sections 239 and 240 are a reasonable means of protecting correlative rights and preventing waste while regulating the production of natural gas from a common source of supply. Together, these statutes provide a legitimate means for fulfilling the state's objectives in preserving its natural gas reserves and protecting the correlative rights of those with an interest in the reserves.

FINDINGS

1. The regulation of natural gas takes by interstate pipelines is an incident of the exercise of this Commission's jurisdiction over the regulation of the production of natural gas from a common source of supply. The exercise of this incidental jurisdiction is necessary in order to protect correlative rights and prevent waste.

2. Sections 239 and 240 and the regulations promulgated thereunder attempt to accommodate interests of both producer and pipeline by adjusting production of natural gas to demand

thereof. The state's interest is furthered by this method by ensuring that production is uniform throughout the common source of supply, protecting against drainage, thus, protecting the correlative rights of all owners of an interest in the natural gas. Any effect such regulation has on interstate commerce is minimal.

3. Commission regulatory jurisdiction over pipeline takes does not encroach upon the jurisdiction of the FERC under the NGA and NGPA. The FERC is not vested with jurisdiction over the production and gathering of gas which is essentially the function of Sections 239 and 240 and the regulations promulgated thereunder.

4. Oklahoma enacted its common carrier and ratable take statutes prior to federal regulation of inerstate pipelines. That regulation of natural gas pipelines by the FERC has changed over the years and again is in the process of significantly changing. This Commission's exercise of incidental jurisdiction is not offensive to the proposed federal regulation. *See, generally, Notice of Proposed Rulemaking,* Regulation of Natural Gas Pipelines After Partial Wellhead Decentral, Docket No. RM85-1-000 (Parts A-D) (Issued May 30, 1985). In light of the present regulatory atmosphere this Commission's jurisdiction can co-exist with and complement that of the FERC.

ORDER

The Commission has reviewed the pleadings filed in this matter and considered all arguments and makes the following determinations:

1. The Commerce Clause of the United States Constitution does not prohibit the enforcement of 52 O.S. § 240 requiring taking of gas against interstate pipelines which are the first purchaser of Oklahoma produced natural gas.

2. The FERC does not have sole authority under the NGA and NGPA over the regulation of gas purchases by interstate

purchasers of natural gas thereby preempting the State of Oklahoma from acting under 52 O.S. § § 239 and 240.

3. The pending causes are hereby directed to proceed on their individual merits.

CORPORATION COMMISSION OF OKLAHOMA

JAMES B. TOWNSEND, Chairman

NORMA EAGLETON, Vice-Chairman.

HAMP BAKER, Commissioner

DONE AND PERFORMED this 3 day of JULY, 1985.

BY ORDER OF THE COMMISSION:

BERDEE S. HOLT, Secretary

GGS/ar